

US-Egypt Business Council

REPORT ON ECONOMIC AND TRADE POLICY DEVELOPMENTS Second Quarter 2003

Egypt is Still Adjusting to the Flotation of the Pound

The implementation of Egypt's January 28 decision to float the pound is still raising some concerns even though it has allowed the pound to depreciate gradually and orderly against the euro and dollar, and has narrowed the gap between the official and black market exchange rates. Decree number 506 of March 24, has been a particular problem for certain companies.

Decree 506 requires companies that earn revenue in foreign currency to convert 75 percent into Egyptian pounds and was prompted by the continued gap in the black market rate for the pound. The decree reportedly has been most actively enforced in the tourism sector where the large companies in the sector often have a high percentage of their transactions denominated in foreign currencies. Analysts have also noted that the decree should be a problem for companies that seek to export manufacturing products. These companies often must import components in order to make products that are competitive on world markets and need foreign exchange for this purpose.

Before introducing Decree 506 in March, the Egyptian government took a number of steps to deal with the foreign exchange shortage and the gap between the official and black market rates. The Central Bank of Egypt (CBE) reportedly released substantial sums of foreign exchange to banks, increased interest rates on local currency to improve the attractiveness of the pound and shut down foreign exchange bureaus that engaged in illicit currency deals. In addition, the pound was helped when the United States extended \$2.3 billion in U.S. loan guarantees and economic grants to offset the negative effects of the war in Iraq.

In early June, IMF Managing Director, Mr. Horst Köhler, gave one the most comprehensive assessments of the problems facing the Egyptian authorities in managing the float of the pound. At a press conference in Dubai on June 6, Köhler was asked whether the float would in the long run help the Egyptian economy given that it did not appear to be doing so now. Because it was not widely reported at the time, Mr. Köhler's statement deserves to be quoted in full here:

Well, I have no doubt that more flexibility in the exchange rate regime is good for Egypt, for its growth and adjustment ability on the medium and long-term. I admit that it takes them a bit longer than we would like them to take, to make a flexible exchange rate regime really working smoothly. But, we should also admit and take into account that they need to build up the technical abilities and facilities for a smooth functioning of a flexible exchange rate. Altogether, I do think that the Egyptian authorities should think further how they can adjust more rapidly to the needs of the global economy. On one hand, they should also move to more transparency and on the second hand, give investors more assurance

that there is less bureaucracy in their administration. I have no doubt that the huge potential of the Egyptian people and country will pay off at the end for all of them.

At present, it is not clear how quickly and the extent to which the Egyptian authorities will remove remaining vestiges of the managed exchange rate system, symbolized by decree 506.

Unified Banking Law -- Far Reaching Implications

The impact of the Unified Banking Law passed in May extends far beyond the question of the Central Bank of Egypt's (CBE) authority over monetary policy. The new law is intended to give the CBE more authority in regulating the banking sector. In contrast, the CBE's authority over monetary policy is still constrained.

In the area of monetary policy, the legislation seeks to harmonize monetary and fiscal policy rather than provide for a central bank whose functions are separate from fiscal policy. The law provides that monetary policy is to be formulated through a Monetary Policy Committee (MPC), which will include some members of the Board of Directors of the CBE as well as ministers and independent experts appointed directly by the President. Thus, the CBE will be under the direct control of the President, as he will appoint both the Governor of the CBE and the Monetary Policy Committee.

Of even more significance, the new law is envisaged as one of the major government initiatives aimed at modernizing the banking sector in Egypt. This modernization strategy is in part the result of Egypt's participation in the IMF/World Bank's Financial Sector Assessment Program, which seeks the diagnosis of potential vulnerabilities and analysis of development priorities for the financial sector of the participating countries. The Government has already taken a number of steps over the last year to strengthen the banking sector and more are planned. The heads of six state-owned banks have been removed and replaced with managers from the private sector. In addition, second-level managers and credit officers have received new training. The new law allows banks to more easily seize collateral from defaulters and facilitates the process of defaulters settling their loans with the banks so that companies can restructure and continue in operation. The CBE will also have new supervisory authority over banks and will closely monitor their lending activities. Egypt is also developing a better credit rating system to further facilitate sound bank lending practices. The financial sector strategy seeks to bring about a more developed banking system similar to that in economically advanced countries. However, some commentators, including the World Bank, have criticized the slowness of the process of privatizing the state-owned banks, which they consider a key step in modernizing the banking sector.

IPR Protection-Some Progress Noted

Egypt's passage of an intellectual property rights law (IPR) last year resulted in it being promoted on May 1 from a "priority watch list country" to "watch list country" in the U.S. Trade Representative's (USTR) annual report on the adequacy and effectiveness of IPR protection around the world (the Section 301 Report). This marks the first time since

at least 1997 that Egypt has not appeared on the priority watch list. The new Section 301 Report notes that:

Egypt made significant progress in strengthening its IPR protections through improvements in its domestic legal and enforcement regimes in 2002. The major development in 2002 was Egypt's passage of a new comprehensive IPR law which represents an improvement in all major facets of Egypt's IPR regime.

The report adds that while the new law meets certain key requirements of the WTO Agreement on Trade-Related Intellectual Property Rights (TRIPS), some provisions in Egypt's IPR laws are still inconsistent with TRIPS. In particular, the report states that Egypt must address TRIPS-inconsistencies in the areas of copyrights, trademarks, and patents, as well as take steps to further strengthen protection of confidential test data, but notes Egypt has committed to address deficiencies in its IPR law through implementing regulations.

The report further states that Egypt must make improved enforcement of IPR laws a priority and do more to reduce piracy. However, the report welcomes Parliamentary approval of Egypt's membership in the World Intellectual Property Organization's (WIPO) Patent Cooperation Treaty (PCT). Following this approval, Egypt deposited its instrument of ratification on June 6 and will become the 121st member of the PCT effective September 6. The PCT system facilitates the process of obtaining international patent protection by providing applicants seeking patent protection in multiple countries the ability to file one "international" patent application with one patent office.

TIFA Working Groups Offer Opportunities

In a meeting on October 1, 2002, USTR Robert Zoellick and Egyptian Foreign Trade Minister Youssef Boutros Ghali agreed to form working groups to facilitate rapid progress on priority trade and investment issues in such areas as Customs Administration, Government Procurement, and Sanitary and Phytosanitary (SPS) issues related to agricultural trade. The October 1 meeting took place under the auspices of the U.S.-Egypt TIFA Council, a joint body created by the U.S.-Egypt Trade and Investment Framework Agreement (TIFA). Since October the working groups have met regularly and have particularly focused on agriculture, SPS and customs matters. The working group process deserves to be followed closely as it is a useful vessel for laying the groundwork for free trade agreement (FTA) negotiations and demonstrating that they can succeed.